

The Honorable Marsha Pechman

FILED ENTERED
LODGED RECEIVED

OCT 14 2005 DJ

AT SEATTLE
CLERK U.S. DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
BY DEPUTY

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

COSTCO WHOLESALE CORPORATION, a
Washington corporation,

Plaintiff,

vs.

ROGER HOEN, VERA ING, and MERRITT
LONG, in their official capacities as members
of the Washington State Liquor Control Board,

Defendants, and

WASHINGTON BEER AND WINE
WHOLESALE ASSOCIATION, a Washington
non-profit corporation,

Intervenor Defendant.

No. 04-CV-00360-MJP

WASHINGTON WINE INSTITUTE'S
AMICUS BRIEF IN RESPONSE TO
DEFENDANTS' AND INTERVENOR'S
RESPONSE TO PLAINTIFF'S MOTION
FOR PARTIAL SUMMARY JUDGMENT
ON PLAINTIFF'S DIRECT SHIPPING
CLAIM

[NOTE ON MOTION CALENDAR:
OCTOBER 21, 2005]



04-CV-00360-HR

I. INTRODUCTION

The Washington Wine Institute (the "Institute") files this brief as *amicus curiae* because of the dire threat posed to Washington wineries by the proposed remedy advanced by the members of the Liquor Control Board and the Washington Beer and Wine Wholesale Association (together, "Defendants"). In response to Costco's argument that Washington's current system of distributing wine to retailers is unconstitutional, Defendants ask this Court to

WASHINGTON WINE INSTITUTE'S
AMICUS BRIEF -- I

M32978-649937

ORIGINAL

1 strike down the statutory right enacted explicitly to allow Washington's domestic producers to
2 sell directly to retailers. Terminating this right would require Washington producers to sell only
3 through licensed wholesalers (represented here by the Intervenor Defendant). This would
4 devastate a significant number of Washington producers, many of whom produce in volumes too
5 small to interest distributors or could not remain financially viable if forced to operate solely
6 using the wholesale distribution model.

7 If the Court finds that Washington's system of distributing wine to retailers is
8 unconstitutional, it either: (a) should extend to all producers, regardless of domicile, the right to
9 choose whether to sell directly to retailers; or (b) stay the enforcement of its order for a period
10 sufficient to permit the Washington legislature to act on the matter. In no case should the Court
11 void the existing right of Washington producers due to the extreme hardship and irreversible
12 consequence such action would cause to the Washington wine industry and the fact that neither
13 solution would work any substantial harm to wholesalers or to the state.¹

14 The Institute is shocked that the Liquor Control Board, which represents itself as giving
15 consideration to the interests of all interested parties, elected not to discuss its position on this
16 issue with the Institute before filing its brief and elected to advance the financial interests of the
17 Intervenor Defendant by further protecting them from out-of-state competition at the expense of
18 the very survival of hundreds of Washington wineries. Washington wines compete with the best
19 wines from around the globe, and the Institute welcomes the lifting of barriers that restrict
20 competition.

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25 ¹ The Institute expresses an opinion only as to the remedies proposed by the parties in the event the Court finds that
26 Washington law regarding distribution of wine to retailers is unconstitutional. The Institute expresses no opinion as
to the constitutionality of such laws, and expresses no opinion regarding any other issue presented in this case.

II. FACTUAL BACKGROUND

The Institute is a trade association representing most of Washington's approximately 350 domestic wineries. Its members range from the smallest garage winemaker to the largest of Washington wineries, which collectively produce over 16 million of gallons of wine annually, and support more than 14,000 jobs in Washington, and add more than \$3.0 billion to the state's economy.

Washington law permits Washington wineries to distribute wine in three principal mechanisms—Washington wineries may sell directly to consumers; directly to retailers (including restaurants and specialty wine stores) for resale to consumers; and to wholesalers for resale to retailers.

The three-tier system, in which wineries sell to wholesalers for resale to retailers, is effective for certain producers in some circumstances, but does not serve the needs of many Washington wineries.

First, the wholesalers will not service all wineries. This is especially a problem for smaller wineries that do not have the volume or market power to command the wholesalers' attention. Wholesalers historically have concentrated their efforts on relatively few of Washington's wineries and carrying only the most popular of those wineries' items.

Second, wineries need efficient distribution to make their businesses economically viable. Wine production is highly capital-intensive, and the wine business is fiercely competitive. Even if a smaller producer were able to find a wholesaler willing to represent it, the cost structure of the wholesale distribution business model is likely to be unsustainable for the winery.²

² If the winery sells directly to the retailer, the winery retains most or all of the margin that otherwise would go to a distributor. This direct to retailer distribution model has allowed smaller Washington wineries to become viable businesses and has in large measure contributed to the substantial growth in Washington wineries over the last fifteen to twenty years.

1 Third, when a wholesaler is put in control of producers' sales to retailers, the wholesaler
2 inevitably will favor one producer over another. Smaller wineries tend to get lost in this process,
3 and they do not receive the brand promotion and development that is, in theory, the principal
4 value that the wholesalers add in this business model.

5 The plight of wineries spurned by wholesalers, yet forced to deal with them, is well
6 described in *Granholm v. Heald*, 125 S.Ct. 1885, 161 L.Ed.2d 796 (2005). There, the Court
7 pointed out that, while the number of U.S. wineries has expanded significantly in the last two
8 decades, the number of distributors has shrunk: "The increasing winery-to-wholesaler ratio
9 means that many small wineries do not produce enough wine or have sufficient consumer
10 demand for their wine to make it economical for wholesalers to carry their products." *Id.* at
11 1892. With respect to one of the winery parties in that case, the Court found that "[e]ven if the
12 winery could find a Michigan wholesaler to distribute its wine, the wholesaler's markup would
13 render shipment through the three-tier system economically infeasible." *Id.* at 1893.

14 The Institute decided to file this amicus brief when it learned of the remedy proposed by
15 the Defendants in response to Costco's motion for summary judgment on its Commerce Clause
16 claims. If this Court determines that Washington law regarding distribution of wine to retailers is
17 unconstitutional, it literally will hold the power of life or death over a significant portion of the
18 state's wine industry.

19 III. ARGUMENT

20 The parties to this action have proposed two potential remedies. Costco has proposed
21 granting out-of-state producers the same right domestic producers now have -- to sell directly to
22 retailers if they so choose. The Defendants have proposed striking that right from the law, and
23 subjecting Washington's wineries to the requirement that all winery sales to retailers must be
24 made through wholesale distributors.

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WASHINGTON WINE INSTITUTE'S
AMICUS BRIEF -- 4

1 Costco and the Defendants have briefed the Court fully on the legal arguments that
2 support their views regarding the appropriateness of their respective proposed remedies. The
3 Institute need not repeat or rebut these arguments here.

4 What is more important is that the Court clearly understand the devastating effects that
5 would result from the acceptance of the Defendants' proposal. A decision that voids Washington
6 wineries' existing right to sell directly to retailers would bring a significant amount of commerce
7 to a halt and would have disproportionately severe and immediate consequence for many of the
8 state's smaller wineries. The attached affidavits and declarations describe these consequences in
9 greater detail.

10 The Institute also urges the Court to make a prompt decision on this issue. If the Court
11 finds Washington law regarding distribution of alcoholic beverages to retailers to be
12 unconstitutional, then the legislature will be called upon to act, regardless of which remedy the
13 Court may adopt – if Costco's remedy, the legislature would need to adopt laws to regulate the
14 rights and obligations of all wineries selling into the state; if the Defendants' remedy, the
15 legislature would need to act to address, during the pendency of a Court-imposed stay, what
16 rights it determines are appropriate for all wineries to possess for distribution directly to retailers.

17 The Washington legislature convenes on January 9, 2006 for a 60-day session. If the
18 Court does not act on this issue until the 2006 session has ended, it is unlikely that the legislature
19 would be able to address the issue for a least another year. Such a delay is likely to cause
20 significant uncertainty in both the business and regulatory communities that would be
21 unnecessary if the Court acted quickly allowing the legislature to address the issue in its
22 shortened 2006 session.

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WASHINGTON WINE INSTITUTE'S
AMICUS BRIEF -- 5

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IV. CONCLUSION

If the Court finds Washington law regarding distribution of wine to retailers unconstitutional, the remedy of terminating Washington wineries' existing right to sell to retailers would result in significant, immediate and irreparable damage to the Washington wine industry. The Institute believes that it is irresponsible of the Defendants to propose such a severe and damaging remedy. The Court should act so as not to needlessly damage the businesses of many Washington wineries, and the Court should act promptly so that the Washington legislature may have the opportunity to address these issues in its 2006 session.

DATED this 14 day of October 2005.


Mark A. Magbie
WSBA# 19374
Attorney for Amicus Curiae Washington Wine
Institute

WASHINGTON WINE INSTITUTE'S
AMICUS BRIEF -- 6


M2978-649937

DECLARATION OF SERVICE

I, Lacey F. Hayes, hereby declare under penalty of perjury of the laws of the State of Washington that on this day I caused to be served a true and correct copy of the pleadings to which this declaration is attached, by the method indicated below, and addressed to each of the following:

John Guadnola Gordon, Thomas, Honeywell, Malanca, Peterson & Daheim, LLP 1201 Pacific Avenue, Suite 2100 P.O. Box 1157 Tacoma, WA 98401-1157 Fax: 253-620-6565	<input checked="" type="checkbox"/> U.S. Mail, Postage Prepaid (10/17/05) <input type="checkbox"/> Hand Delivered <input type="checkbox"/> Overnight Mail <input checked="" type="checkbox"/> Facsimile Transmission
David J. Burnan Perkins Coie 1201 Third Ave., Suite 4800 Seattle, WA 98101-3099 Fax: 206-359-9000	<input checked="" type="checkbox"/> U.S. Mail, Postage Prepaid (10/17/05) <input type="checkbox"/> Hand Delivered <input type="checkbox"/> Overnight Mail <input checked="" type="checkbox"/> Facsimile Transmission
Michael D. Sandler Sandler Ahern & McConaughy PLLC 1200 Fifth Avenue, Suite 1900 Seattle, WA 98101-3135 Fax: 206-346-1755	<input checked="" type="checkbox"/> U.S. Mail, Postage Prepaid (10/17/05) <input type="checkbox"/> Hand Delivered <input type="checkbox"/> Overnight Mail <input checked="" type="checkbox"/> Facsimile Transmission
David M. Hankins Martha P. Lantz Assistant Attorneys General P.O. Box 40123 Olympia, WA 98504 Fax: 360-665-2023	<input checked="" type="checkbox"/> U.S. Mail, Postage Prepaid (10/17/05) <input type="checkbox"/> Hand Delivered <input type="checkbox"/> Overnight Mail <input checked="" type="checkbox"/> Facsimile Transmission

DATED this 14th day of October 2005, at Seattle, Washington.


 Lacey F. Hayes

WASHINGTON WINE INSTITUTE'S
AMICUS BRIEF -- 7

The Honorable Marsha Peckman

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WASHINGTON WINE INSTITUTE'S
AMICUS BRIEF -- 1

M32978-649937

ORIGINAL

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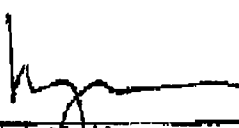
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WASHINGTON WINE INSTITUTE'S
AMICUS BRIEF -- 5

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DATED this 14 day of October 2005.


Mark A. Magbie
WSBA# 19374
Attorney for Amicus Curiae Washington Wine
Institute

WASHINGTON WINE INSTITUTE'S
AMICUS BRIEF -- 6


M32976-648931

DECLARATION OF SERVICE

I, Lacey F. Hayes, hereby declare under penalty of perjury of the laws of the State of Washington that on this day I caused to be served a true and correct copy of the pleadings to which this declaration is attached, by the method indicated below, and addressed to each of the following:

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DATED this 14th day of October 2005, at Seattle, Washington.


Lacey F. Hayes

WASHINGTON WINE INSTITUTE'S
AMICUS BRIEF -- 7